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BANKRUPTCY COURT
OAKLAND, CALIFORNIA

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

No. 99-44867 JG
Chapter 13

WINSTON REED and
BARBARA REED,

Debtors.

DECISION

Martha G. Bronitsky, standing chapter 13 trustee (the "trustee"), has filed a motion to dismiss this case with prejudice. The court will grant the motion.

A. Background

On July 26, 1999 debtors Winston and Barbara Reed (the "debtors") filed a chapter 7 petition herein. On August 3, 1999, the debtors filed amended schedules showing that they owned an interest in real property described as the "R Ranch." The debtors' schedules stated that the R Ranch had a fair market value of \$5,000 and was encumbered by a lien in the sum of \$3,100. The debtors' schedules further stated that the debtors were not parties to any executory contracts, and that their monthly expense for rent was in

Decision

1 the sum of \$900.

2 On August 12, 1999, the debtors converted their chapter 7 case
3 to chapter 13.

4 In December 1999, the debtors decided to purchase a certain
5 parcel of residential real property in Hercules, California (the
6 "Residence"). On either January 6 or January 7, 2000,¹ the debtors
7 entered into a contract with the owners, Dennis and Corazon Zapanta
8 (the "Zapantas"), to acquire the Residence and to assume the two
9 deeds of trust thereon (the "Contract").

10 Barbara Reed testified that the Contract, although inartfully
11 drafted, entitled the debtors to take immediate occupancy of the
12 Residence, required them to service the deeds of trust thereon for a
13 period of two years, assume approximately \$155,200 in debts secured
14 by those deeds of trust, and close a purchase within two years of
15 the date they assumed possession. This testimony is generally
16 consistent with the allegations of a complaint the debtors filed
17 against the Zapantas in California Superior Court in January 2002,
18 which alleged, among other things, that pursuant to the Contract,
19 the debtors "agreed to buy and defendants, Zapantas, and each of
20 them agreed to sell" the Residence.

21 On January 6, 2000, the same date as appears on the Contract,
22 the meeting of creditors for the debtors' chapter 13 case was held

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25 ¹The Contract is dated January 6, 2000. Barbara Reed
26 testified that it was actually signed on January 7, 2000.

1 pursuant to Bankruptcy Code § 341(a).² The debtors appeared with
2 their counsel, Cathleen Moran, who had been representing the debtors
3 continuously from the filing of the chapter 7 petition and who
4 continues to serve as the debtors' counsel herein. No creditors
5 appeared. At the meeting of creditors, the trustee did not ask the
6 debtors whether the R Ranch was the only real property in which they
7 had an interest, or whether the information in their schedules
8 remained accurate.

9 Nor did the debtors voluntarily disclose that they had entered
10 into, or were about to enter into, a contract that would materially
11 alter their entire financial position by substantially increasing
12 their assets, liabilities, and monthly expenses. Based on the
13 information available to the trustee, the trustee advised debtors
14 and their counsel that she would recommend confirmation of the plan.
15 On January 10, 2000 (three or four days after the debtors had signed
16 the Contract), the court entered its order confirming the debtors'
17 plan.

18 At the time the court signed the order, the debtors' actual
19 monthly expense for housing was \$1,800 because of the liabilities
20 they had assumed under the Contract, and not the \$900 amount
21 indicated in their schedules.

22 Thereafter, the debtors sought to amend their plan. On July
23 18, 2000, the debtors filed an application to modify the plan, which
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25 ²All further section references herein are to the Bankruptcy
26 Code, 11 U.S.C. § 101 et seq.

1 application stated that the modification was needed because "[t]he
2 current plan is not feasible." Neither the application nor the
3 declaration of counsel filed in support thereof mentioned the
4 Contract. Nor did the application disclose that, in fact, the plan
5 since confirmation had never been feasible because the debtors had
6 rendered it unfeasible prior to confirmation. In essence, the
7 proposed plan modification eliminated the 10% dividend to unsecured
8 claimants required under the confirmed plan. The debtors submitted
9 no schedule amendments in connection with the application, which the
10 court granted by order filed September 27, 2000.

11 In January 2002, the debtors filed a lawsuit against the
12 Zapantas and others seeking to enforce their purchase rights under
13 the Contract and damages.³ Thereafter, the trustee discovered that
14 the debtors' actual financial position as of the date the court
15 confirmed their plan, and as of the date the court approved the plan
16 modification, was quite different than that represented in their
17 schedules. The present motion followed.⁴

18 B. Discussion

19 Pursuant to § 1307(c), the court may dismiss a chapter 13 case

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21 ³Barbara Reed testified that the suit has since been settled
22 as to the Zapantas under an arrangement by which the debtors
23 assigned their purchase rights to debtor Winston Reed's mother,
24 who then bought the Residence. She also testified that the
25 debtors now reside at the Residence, and that the action remains
26 pending as to the other defendants.

27 ⁴Unlike a motion to revoke confirmation pursuant to § 1330,
28 a motion to dismiss a case for cause under § 1307(c) is not
29 subject to any statutory time limitations.

1 for cause. Pursuant to § 349(a), the court may dismiss a case with
2 or without prejudice. A debtor's bad faith is cause for dismissal
3 with prejudice. In re Leavitt, 171 F.3d 1219, 1224 (9th Cir. 1999).
4 Bad faith involves application of a "totality of circumstances"
5 test, under which the court should consider, among other things:

- 6 (1) whether the debtor misrepresented facts in his
7 [petition or] plan, unfairly manipulated the Bankruptcy
8 Code, or otherwise [filed] his Chapter 13 [petition or]
9 plan in an inequitable manner;
10 (2) the debtor's history of filings and dismissals;
11 (3) whether the debtor only intended to defeat state
12 court litigation; and
13 (4) whether egregious behavior is present.

14 Leavitt, 171 F.3d at 1224 (internal citations and quotes omitted).

15 Here, the court finds that the debtors unfairly manipulated the
16 Bankruptcy Code, obtained an order confirming their chapter 13 plan
17 in an inequitable manner, and engaged in egregious behavior that
18 provides cause for a dismissal with prejudice.

19 It is essential that a chapter 13 trustee have accurate
20 information regarding, among other things, the income and expenses
21 of debtors seeking plan confirmation so that the trustee may
22 determine whether a proposed chapter 13 plan meets the requirements
23 of chapter 13,⁵ and thus, whether the trustee should object to or

24 ⁵Section 1325(a)(6) provides that to confirm a chapter 13
25 plan, the court must find that "the debtor will be able to make
26 all payments under the plan and to comply with the plan."
Section 1325(b)(1) prohibits confirmation of a chapter 13 plan
over the objection of an unsecured creditor or the trustee unless
"the plan provides that all of the debtor's projected disposable
income to be received in the three-year period beginning on the
(continued...)

1 recommend confirmation to the court in fulfillment of the trustee's
2 responsibilities under § 1302.⁶ See In re Andrews, 49 F.3d 1404
3 (9th Cir. 1995). Here, however, the court signed a confirmation
4 order on January 10, 2000 and approved a plan modification on the
5 basis of information that, by design of the debtors,⁷ had no
6 relationship to reality, under circumstances where the actual facts
7 were unknown to the trustee and the court. After the court
8 confirmed the plan, the debtors, in violation Fed. R. Bankr. P.
9 4002(5),⁸ failed to report their change of address to the trustee,
10 thereby forestalling discovery of their true financial position for
11 several years. Barbara Reed testified that she failed to do so
12 because "a lot of things [were] going on."

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14 ⁵(...continued)
15 date that the first payment is due under the plan will be applied
16 to make payments under the plan."

17 ⁶Section 1302 provides, in relevant part: "The trustee shall
18 . . . appear and be heard at any hearing that concerns . . .
19 confirmation of a plan."

20 ⁷ Barbara Reed initially testified at trial that the debtors
21 had decided to purchase the Residence in December 1999.
22 Subsequently, she testified that the debtors did not make their
23 decision to purchase until January 7, 2000, the day after the
24 date on the Contract and the day after the meeting of creditors
25 was held. The court declines to accept the proposition that it
26 was mere coincidence that the debtors signed the Contract the day
of or the day after the meeting of creditors.

⁸Fed. R. Bankr. P. 4002(5) provides: "In addition to
performing other duties prescribed by the Code and rules, the
debtor shall . . . file a statement of any change of the debtor's
address."

1 Moreover, the debtors violated § 364(c) by contractually
2 obligating themselves to incur secured debt prior to confirmation of
3 the plan, without court approval.⁹

4 The debtors raise three arguments in opposition to the
5 trustee's motion. First and primarily, they argue that they have no
6 duty under the Bankruptcy Code to amend their schedules to reflect
7 developments after the schedules are filed. Second, they argue that
8 they had no duty to volunteer information to the trustee at the
9 meeting of creditors or otherwise, and that because the trustee did
10 not ask them whether they had contracted to purchase real property
11 and assume debt, or whether they planned to do so in the immediate
12 future, they were within their rights to remain silent. Thirdly,
13 they argue that no one was harmed.

14 The court rejects these arguments. As to the first, it is true
15 that the Bankruptcy Code and Bankruptcy Rules do not generally
16 require bankruptcy debtors to amend their schedules to reflect
17 developments after the schedules are filed.¹⁰ In re Adair, 253 B.R.

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19 ⁹Filing of a chapter 13 petition creates an estate. Section
20 541(a). The property of the estate does not revert in the debtor
21 until plan confirmation. Section 1327(b). Prior to such
22 revesting, the debtor, absent court authority, may not use or
sell estate property out of the ordinary course of business,
§ 1303, or incur secured debt. Section 364(c).

23 ¹⁰In some situations, not applicable here, debtors are
24 required to file amendments to their schedules. See Fed. R.
25 Bankr. P. 1007(h). And if a debtor acquires real property before
26 the debtor files his or her schedules, the debtor must report the
acquisition to the trustee. Fed. R. Bankr. P. 4002(3). This
(continued...)

1 85 (9th Cir. BAP 2000). It does not follow, however, that debtors
2 may permissibly conceal information and mislead the trustee and
3 court in order to obtain plan confirmation. Rather, under § 521(3),
4 a debtor has a duty to "cooperate with the trustee as necessary to
5 enable the trustee to perform the trustee's duties under this
6 title." Obviously, the debtors' withholding of material information
7 that the trustee needed to perform her duties is not cooperation.

8 Moreover, even if the debtors were not required to amend their
9 schedules, they did not have license, as their second argument
10 contends, to mislead and deceive the trustee and court by their
11 silence, or to request confirmation of a plan that they knew was not
12 feasible on account of facts that were not available to the parties
13 in interest or court. See In re Hamilton, 270 F.3d 778, 784 (9th
14 Cir. 2001) (discussing the importance of full disclosure by debtors
15 seeking plan confirmation and the applicability of judicial estoppel
16 to the facts at issue therein); In re Coastal Plains, Inc., 179 F.3d
17 197 (5th Cir. 1999).¹¹

19 ¹⁰(...continued)
20 requirement, however, was not applicable here because the debtors
21 acquired their interest in the Residence after they had filed
their schedules.

22 ¹¹These cases and other cases cited therein stress the duty
23 of debtors to make full disclosure of all relevant financial
24 information prior to confirmation of a chapter 11 plan. The
25 court believes that chapter 13 debtors seeking plan confirmation
26 likewise have a duty not to mislead the court or parties in
interest by concealing information relevant to the confirmation
process.

1 Barbara Reed admitted that she knew at the time she attended
2 the meeting of creditors that the trustee had a duty to review the
3 debtors' financial position, and make a recommendation to the court
4 concerning confirmation. The debtors also knew at such time that
5 their financial information had changed or was just about to change
6 dramatically. Yet they remained silent as if bankruptcy were a game
7 in which the winners are the debtors who can successfully hide
8 material information from the trustee, the creditors, and the court.

9 The court holds that under the circumstances present here, the
10 debtors had a duty to speak up at the meeting of creditors, and that
11 they violated that duty by not doing so.

12 Adair is not to the contrary. In Adair, a chapter 7 trustee
13 had moved to reopen a case three years after it had been closed, in
14 order to claim the proceeds from the settlement of a lawsuit that
15 the debtor had properly scheduled and which the trustee had chosen
16 not to administer. Adair, 253 B.R. at 86. The BAP affirmed the
17 trial court's denial of the motion, noting that the debtor had
18 complied with her duty to file accurate schedules, and had no
19 ongoing duty to update them as events changed. Id. at 90. Nothing
20 in Adair, however, condones conduct of the type engaged in by the
21 debtors here. Indeed, the Adair court noted that the trustee
22 therein, unlike the trustee herein, was not "deprived of sufficient
23 information so as to preclude him from performing his duties." Id.
24 at 89.

25 The debtors' final argument is that no one was harmed. The
26 court rejects this argument. How this chapter 13 case might have

1 proceeded, if at all, and how the creditors may have fared had the
2 court known the actual facts as they existed at the time it
3 confirmed the plan is a matter of pure speculation. Possibly the
4 case would have been dismissed based on the infeasibility of the
5 plan, in which case the creditors could have acted several years ago
6 to protect their interests without being stayed by § 362(a). See
7 Hamilton, 270 F.3d at 784. In any event, even if no creditors were
8 harmed, this would not excuse the debtors' misconduct herein. See
9 In re Adeeb, 787 F.2d 1339, 1343 (9th Cir. 1986) (holding that lack
10 of harm to creditors is irrelevant to the issue of whether a debtor
11 can be denied a discharge when grounds for denial are present).

12 C. Conclusion

13 The court will dismiss this case with prejudice, and requests
14 the trustee to submit a proposed order within 10 days.

15 Dated: August 13, 2002

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18 Edward D. Jellen
19 United States Bankruptcy Judge
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